

Presentation to Joint Appropriations Committee on General Government

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The purpose of the Department of Revenue is to produce the right amount of revenue – no more and no less – collected equitably under the law and with respect for the rights and dignity of all taxpayers.

The overarching program of the Department of Revenue is the administration of revenue laws. That single program generates two mutually supportive outcomes:

- Revenue for state and local governments and school districts and
- Equity and fairness for taxpayers – both individuals and businesses.

While our liquor control activities protect public health and safety, they also produce revenue through taxes and operational profits for the state general fund and special revenue accounts. Our abandoned property work returns property to their rightful owners, but it also generates substantial general fund revenue. Importantly, the efficiency and effectiveness of the Department helps define the extent of budgetary policy choices available to this Legislature. The more the Department succeeds the more choices you enjoy.

In recent fiscal years the Department has ensured the collection of \$2.5 billion in state and local revenue annually at an administrative cost of only 2% of the amount collected. In the last two fiscal years, we have produced record revenues from our active compliance efforts. The efficiency of our compliance work is also setting records – with our average rate of return running at \$8 for each \$1 invested in this work over the last two fiscal years. We have more than doubled this rate of return since FY 2002. Our return is also twice what is considered an efficient compliance return at the national level. Because of our efficient and effective compliance efforts and efficiencies

in liquor operations, this Legislature has convened with approximately \$150 million extra in the state general fund balance.

What are the benefits of better tax compliance?

Fairness in Taxation: Honest and diligent taxpayers who pay the right amount of taxes on time are protected from having to pay even more taxes to make up for those individuals and businesses not paying their fair share under Montana law. Small businesses, homeowners, and farmers and ranchers are also protected from unfair property tax increases when the Department successfully defends the market values for the large cases with recurring appeals.

A Stronger, Growing Economy: The Montana economy and jobs grow on a sustained basis when taxes are equalized so that businesses compete on a level playing field . . . and when proper revenues are returned from out-of-state taxpayers to flow again through the state's economy.

A Brighter Future for Montana: The future for all Montanans is improved through efficient public services, solid infrastructure and investments in education for higher paying jobs.

The Department of Revenue produces these benefits through a single interrelated set of activities – all of the parts work together to produce proper revenue collections and fairness for taxpayers. The Department is like a pickup truck, where all the major parts must work if the vehicle is to travel successfully. If the battery is dead, the fuel system is blocked, or the brakes are worn out, the pickup will not reach its desired destination. In the same way, the Department is a single system of interrelated parts all of which must function well and in balance with each other if the revenue laws are to be administered effectively. If the Department did not provide understandable forms, instructions and procedures – if it did not certify private sector tax preparation software – if it did not answer questions from taxpayers – if it did not open the mail, deposit payments in the banks and record information from returns – if it did not pay

refunds promptly—if its computers did not work right — if it did not identify non-filers and new construction — if it did not review and audit returns or appraise property — if it did not send notices of taxes due and collect delinquent taxes — if it did not certify values to local governments and provide county treasurers with individual tax billing information — if it did not properly account for and distribute funds – and if its managers and attorneys did not carefully guide, support and defend this work — if any single part of the Department fails to work, Montana’s revenue system would cease to function. The only difference among any of these activities is the speed at which the system comes to a halt if any of the parts fail to work. So there is no ranking of funding priorities to be established among these activities — they all need to be kept in balance with each other for the Department to achieve optimum efficiency and effectiveness in producing revenue for state and local government and fairness for taxpayers. In fact, if the Legislature were to establish a ranking of funding priorities among these activities, the risk of serious damage to the revenue system would increase.ⁱ

So there is only one fundamental issue concerning the Department’s budget and that is the extent to which the Legislature wants its revenue laws to be properly and equitably administered. If funding is provided as proposed in the Executive Budget — which includes savings from operational efficiencies we have achieved — revenues will increase and fairness among taxpayers will continue to improve — and all the benefits that flow from that gain in revenue and fairness will be enhanced. On the other hand, if Department funding is reduced below the Executive Budget, revenues will decline — conservatively — by six times the amount of the expenditure reduction, and — even worse — inequities among taxpayers will increase. Let us be very clear about this. A reduction in the budget of the Department of Revenue does not help the state’s general and special revenue fund balance sheets — it hurts those balance sheets. It would also hurt the balance sheets of local governments and school districts. Whatever your definition and goal for structural fiscal balance may be, a cut in the Department of Revenue’s budget will move the state’s finances further away from, not closer to, any

goal you set for fiscal balance. You move backwards, not forwards, away from your goal.

How do we know that a change in the Department of Revenue's budget will cause an even larger change in revenues? We know that from the evidence of actual tax agency budget experience in Montana and in other states when revenue agency budgets have changed. When several other state revenue agency budgets were increased, revenues in those states increased by a multiple of 5.8 to 14.7 times the increase in expenditures. Right here in Montana, a budget increase in 2005 enabled the Department to return properly collected revenues 10 times of that budget amount in the first full biennium after the change – with a further return of 14 times of that amount in the second biennium. In contrast, when legislatures in other states cut their state revenue agency budgets, revenues in those states declined by 5 to 15.4 times the expenditure cuts – resulting in a negative impact on the fiscal health of those states. Changes in revenue agency budgets have a multiplier effect on revenues several times the amount of the budget changes – and a multiplier of six is conservative in light of the available independent evidence.

Thus, in the 5% reduction plan required to be submitted under law, we project that a cut of about \$5 million from Department of Revenue's budget will reduce revenues by \$30 million dollars in the 2013 biennium. If action were taken along these lines – and we do not support that action – the Legislature should adjust its revenue estimates downward by \$30 million to reflect this decline in revenues.

More simply put, you cannot expect a pickup to get more miles per gallon by putting less gas in the tank.

On the other hand, the Executive Budget includes a decision package for enhancing tax compliance activities – and that package would generate an additional \$5 million in revenue. We also propose decision packages that will sustain and improve other specific compliance efforts – including a package that will also help to guarantee

that the State of Montana continues to receive \$30 million dollars or more each year from tobacco companies under the [master settlement agreement](#). We will discuss these proposals in more detail in your further proceedings.

A reduction in the budget of the Department of Revenue will also produce greater inequities in taxation that would harm ordinary, middle class Montanans. We know this because ordinary Montanans pay their taxes voluntarily on time and in the right amount at a very high rate. On the other hand, non-residents and out-of-state corporations either fail to file or fail to pay the right amount of taxes at a much higher rate than our own citizens. If the Department does not actively seek compliance from those who fail to file or underreport income or receipts, those Montana citizens and businesses who do pay the right amount of taxes will be justifiably upset about picking up the tab for non-residents and out-of-state corporations. Further, if the Department – after review with the affected taxpayers – does not defend assessments that it considers valid and proper, taxes will be unfairly shifted to Montana wage earners, homeowners, small businesses and farmers and ranchers. Fair competition in the marketplace would suffer to the disadvantage of Montana businesses. In addition, revenue that the Department would otherwise properly assess and collect from non-residents and out-of-state companies would decline – reducing the return of these funds to Montana to circulate again in our economy – with the ultimate consequence of reducing jobs in Montana. A cut in the Department’s budget not only hurts government balance sheets by a multiple of six times the budget cut, it also harms the majority of Montana citizens and small businesses and hurts the state’s economy.

In 1972, the Montana Constitutional Convention addressed the importance of equity in taxation to supporting an open and growing economy and increasing jobs. Constitutional Convention Delegate David Drum – a successful businessman, a founder of the KOA campgrounds and also a former state legislator – spoke to the tax equalization recommendations of the Revenue and Finance Committee as follows:

Now what effect will true equality have of taxation? . . . Our group (referring to the Revenue and Finance Committee) feels that if Montana is to go ahead, we are going to have to have equalization in the eyes of those who would like to either stay in Montana and invest money or those who would like to come to Montana and invest money, creating more jobs for our young people.

Delegate Drum and his colleagues believed that to encourage long term investment and growth in Montana, an investor would need to be assured that they would not pay more in taxes because someone else – especially a competitor – paid less than their proper share under the law. Efficiency and growth in business and jobs depends on fair and equal competition in the marketplace based on a foundation of everyone paying a fair share of taxes – with no business gaining an unfair advantage over others. In that manner, the Department believes that its activities are vital to supporting sustainable economic growth and higher paying jobs in Montana.

We have also – under the leadership of the Governor and support of the Legislature – continually improved our efficiency through a variety of savings and operational changes. The Executive Budget includes expenditure reduction decision packages that await your approval that reflect sustainable reductions in costs that we achieved in the Department.

We have been asked to address the philosophy that underlies our budget proposals. The response to that inquiry is simple. Our philosophy is defined by the Constitution and laws of Montana – that we apply the tax laws equitably and fairly so the amount of revenue required by the law is actually collected as nearly as possible – and that we do so with respect for the rights and dignity of every person we affect. If we are allowed to do our job well, all Montana benefits and prospers.

ⁱ See “Montana’s Department of Revenue: A Record of Effective, Efficient Tax Administration as a Unitary Business Operation,” at <http://revenue.mt.gov/content/committees/2011-legislative-session/DOR-Unitary-Business.pdf> . This paper describes how the parts of the Department fit together efficiently, the results of the Department’s work and the impact of legislative budget decisions on revenue collections in Montana and other states. The table on page 10 of this paper summarizes the evidence on the multiplier effect that budget changes for revenue agencies have had on state revenues.